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Cure and Revocation for Quality Defects: The Utility of Bargains

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CURE AND REVOCATION FOR QUALITY DEFECTS: THE UTILITY OF BARGAINS

ALAN SCHWARTZ*

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I. INTRODUCTION

The objectives of sales laws, broadly speaking, should be to facilitate the contribution which private bargains can make to achieving desired social goals, such as economic efficiency, and to prevent bargains from yielding unacceptable outcomes, such as the exploitation of weak parties. These objectives cannot be realized, however, without an understanding of the contribution which bargains can make toward achieving particular social goals, the requisite conditions for bargaining effectiveness, and the situations in which exploitation is possible. The unfortunate regulatory choices often made by the Uniform Commercial Code (the Code) are generally explicable as resting on misapprehensions as to one or more of these matters.

I have elsewhere sought to document these misapprehensions in three areas. Initially, I argued that the two goals of optimizing the

* Professor of Law, Indiana University; B.S. Bates College, 1961; LL.B., Yale Law School, 1964. My colleagues Joseph Brodley, Julius Getman and Jon Hirschhoff made quite helpful comments on prior drafts. Any errors which remain are mine.

costs which defective products yield and preventing parties from bearing concentrated losses when defects occur can best be achieved through bargains, but only if the parties thereto are sufficiently informed. I concluded, therefore, that the state should either fill information gaps where they exist or structure the transactions of uninformed parties.¹ The Code, misunderstanding this, neither provides information nor structures bargains.² I have also argued that consumer buyers cannot bargain rationally with respect to clauses requiring them to waive defenses against third party financiers of sales, nor can they rationally contract out of the holder in due course rule, because the information to price the risks which the inability to assert defenses against financiers imposes on such buyers is lacking and cannot be made available except at prohibitive cost. Waiver of defense clauses should thus be prohibited and the holder in due course rule, as applied to consumer sales, should be repealed.³ The Code fails to do either.⁴ Finally, I have argued that the problems posed by unequal bargaining power between sellers and buyers, except as such inequality arises from differential access to information, are not susceptible to sensible solution by the judicial process.⁵ The Code, in part because it rests on erroneous assumptions as to how economic power shapes bargains, delegates much of the task of regulating that power to the courts.⁶

This article further documents the allegation that the Code's regulation of sales transactions frequently rests on misapprehensions regarding the manner in which bargains operate, and thus fails to maximize the contribution of bargains to social welfare. Its subject will be the law regulating the parties' rights when sellers deliver non-conforming goods.

Sales law has long contained a "perfect tender rule," enabling buyers to reject goods for any non-conformity.⁷ This rule has been

¹ Schwartz, *The Private Law Treatment of Defective Products in Sales Situations*, 49 Ind. L.J. 8 (1974) [hereinafter cited as Schwartz].

² See Uniform Commercial Code §§ 2-313 to -16, 2-719.

³ Schwartz, *Optimality and the Cutoff of Defenses Against Financiers of Consumer Sales*, 15 B.C. Ind. & Com. L. Rev. 499 (1974).

⁴ See Uniform Commercial Code §§ 3-302, 3-305, 9-206.

⁵ Schwartz, *Seller Unequal Bargaining Power and the Judicial Process*, 49 Ind. L.J. 367 (1974).

⁶ See Uniform Commercial Code §§ 2-302, 2-719(3). Comment 1 to § 2-302 states its objectives as preventing "oppression and unfair surprise . . . and not . . . disturbance of allocation of risks because of superior bargaining power." The statute itself, however, creates no such limitation, nor have the courts. E.g., *Sarfati v. M.A. Hittner & Sons, Inc.*, 135 App. Div. 2d 1004, 318 N.Y.S.2d 352 (1970); *Educational Beneficial, Inc. v. Reynolds*, 324 N.Y.S.2d 813 (Civ. Ct. 1971).

⁷ Professor Gilmore argues that the rule developed in the late nineteenth century. G. Gilmore, *The Death Of Contract* 79-80 (1974). It was found in Uniform Sales Act §§ 44, 69. The Code's version is § 2-601, which provides:

Subject to the provisions of this Article on breach in installment contracts

almost unanimously, and erroneously, condemned, for two reasons: first, rejection for slight, easily repairable non-conformities allegedly produces economic waste, in that it imposes larger costs on sellers than such non-conformities impose on buyers; and second, buyers may ostensibly reject for slight non-conformities when in fact they are rejecting because the deal seems less profitable than it did at the time the goods were ordered. Such bad faith could defeat a seller's reasonable expectations as to the grounds on which the deal may be upset.⁸

The Code's draftsmen responded to these criticisms in two significant ways. Initially, section 2-508 authorizes sellers to "cure" non-conforming tenders by repair or replacement.⁹ I will show in this article, however, that if buyers act in good faith, rejecting only because of the non-conformities themselves, a cure rule is unnecessary to avoid economic waste since the parties will optimize breach costs through bargains. The Code, moreover, is not only unnecessary, but harmful, for it can be used to impose certain breach costs on buyers unjustifiably and to produce economic waste. Thus, a cure rule is defensible only because it may minimize buyer bad faith.

In this regard, two situations must be distinguished. The first concerns the sale of goods—such as television sets, cars and

(Section 2-612) and unless otherwise agreed under the sections on contractual limitations of remedy (Sections 2-718 and 2-719), if the goods or the tender of delivery fail in any respect to conform to the contract, the buyer may

- (a) reject the whole; or
- (b) accept the whole; or
- (c) accept any commercial unit or units and reject the rest.

The perfect tender rule probably often comports with the parties' expectations; buyers generally expect not to take non-conforming goods and sellers generally expect rejection. Agreement and custom frequently alter these expectations. See text at notes 42-54 *infra*.

⁸ E.g., *Honnold, Buyer's Right of Rejection*, 97 U. Pa. L. Rev. 457, 470, 475 (1949).

⁹ Uniform Commercial Code § 2-508, which provides:

(1) Where any tender or delivery by the seller is rejected because non-conforming and the time for performance has not yet expired, the seller may seasonably notify the buyer of his intention to cure and may then within the contract time make a conforming delivery.

(2) Where the buyer rejects a non-conforming tender which the seller had reasonable grounds to believe would be acceptable with or without money allowance the seller may if he seasonably notifies the buyer have a further reasonable time to substitute a conforming tender.

For thoughtful comment on § 2-508, see J. White & R. Summers, *Handbook of the Law Under the Uniform Commercial Code* § 8-4, at 266-70 (1972) [hereinafter cited as *White & Summers*]; Peters, *Remedies for Breach of Contracts Relating to the Sale of Goods Under the Uniform Commercial Code: A Roadmap for Article Two*, 73 *Yale L.J.* 199, 209-16 (1963); Note, 53 *Iowa L. Rev.* 780 (1967); Note, 69 *Mich. L. Rev.* 130 (1970); Note, 6 *Rutgers Cam. L.J.* 387 (1974). An effective cure, it has been suggested, may also be made by appropriately reducing the price to compensate for the non-conformity. See *Graulich Caterer, Inc. v. Hans Holterbosch, Inc.*, 101 N.J. Super. 61, 243 A.2d 253 (1968); *White & Summers, supra*, § 8-4, at 269. However, no court has explicitly so held.

lathes—the market value of which is stable in the short run. The ultimate purchasers of these goods use them for considerable periods. In this situation—the “use case”—buyer bad faith seldom exists, primarily because the gains to a buyer from so acting will seldom outweigh his costs. Therefore, no Code provision is needed to deal with this virtually non-existent problem.

The second situation concerns the sale of goods—such as commodities and raw materials—which experience substantial short run price fluctuations. Buyers of such goods will often have an incentive to reject in bad faith because the costs of acceptance can be substantial when prices decline. However, the parties in this situation—the “market fluctuation case”—are generally professionals to whom the risk of short run price changes is obvious. The parties thus eliminate this risk by contract.

Bad faith rejections attributable to a decline in market price seem to occur primarily during periods of unanticipated radical price fluctuations, produced by significant events such as war, peace or depression, which suddenly transform use goods into market fluctuation goods. Requiring buyers to accept cure in such cases is unwise because cure is not necessarily the best solution to the problems posed by unanticipated events. Rather, a rule is needed which will provide courts with sufficient flexibility to do justice under the circumstances. A better understanding of the manner in which bargains operate, in sum, will lead to more sensible solutions to the rejection problem than those reached under section 2-508 of the Code.

The second important Code response to the supposed evils of a rule allowing buyers to avoid a transaction for any quality defects is the substantial impairment limitation on the right to revoke acceptance. Section 2-608 of the Code authorizes a buyer who has accepted apparently conforming goods to “revoke his acceptance” thereof if defects later appear, but only if the non-conformity “substantially impairs [the goods’] value to him.”¹⁰ This limitation is intended to preclude waste producing and bad faith revocations,

¹⁰ Uniform Commercial Code § 2-608, which provides:

(1) The buyer may revoke his acceptance of a lot or commercial unit whose non-conformity substantially impairs its value to him if he has accepted it

(a) on the reasonable assumption that its non-conformity would be cured and it has not been seasonably cured; or

(b) without discovery of such non-conformity if his acceptance was reasonably induced either by the difficulty of discovery before acceptance or by the seller's assurances.

(2) Revocation of acceptance must occur within a reasonable time after the buyer discovers or should have discovered the ground for it and before any substantial change in condition of the goods which is not caused by their own defects. It is not effective until the buyer notifies the seller of it.

which supposedly occur when defects are trivial. The revocation of acceptance section, as the cases under it indicate, is relevant primarily to use goods.¹¹ However, in that context the substantial impairment limitation is unnecessary to avoid economic waste, often requires the imposition of breach costs on buyers, and sometimes produces the inefficiencies it attempts to avoid. Moreover, bad faith revocations apparently occur less frequently in use goods markets than do bad faith rejections. Therefore, the substantial impairment limitation should also be repealed.

If these sections were repealed, and buyers were able to avoid transactions for any quality defects, sellers will probably attempt to limit contractually the ability of buyers to so escape, as, for example, by requiring buyers to accept cure. Even under the Code sellers frequently preclude revocation by use of repair and replacement clauses. Such contractual avoidance of the perfect tender rule raises the problem, noted above, of the conditions under which bargains can effectively achieve social goals, in this case the goal of optimizing the risk, rather than the post-tender costs, of breach. In this regard, certain contractual methods of avoiding the perfect tender rule should always be permitted, but others should be prohibited or appropriately restricted.

II. CURE: THE PREVENTION OF ECONOMIC WASTE

A. *Theory*

Under the perfect tender rule, a non-conforming delivery presents the seller with four choices: (1) to compensate the buyer for the goods' decrease in value if the buyer retains them; (2) to repair the goods; (3) to replace the goods should the buyer find them unacceptable in their delivered state, compensating the buyer for any breach costs remaining after either (2) or (3) is done; and (4) to let the deal go. Economic waste will be avoided if the least expensive alternative is selected. The seller is obviously motivated to choose it and the buyer is unable to force other choices, for his power is limited to rejection. If, for example, the least expensive alternative for a seller is to make no deal, but the buyer prefers the more expensive alternative of repair with a large price discount, the buyer cannot compel his own choice. However, should the buyer prefer repair to

(3) A buyer who so revokes has the same rights and duties with regard to the goods involved as if he had rejected them.

For useful comment, see White & Summers, *supra* note 9, § 8-3, at 253-66.

¹¹ See, e.g., *Rozmus v. Thompson's Lincoln-Mercury Co.*, 209 Pa. Super. 120, 224 A.2d 782 (1966); *Campbell v. Pollack*, 101 R.I. 223, 221 A.2d 615 (1966). For a possible exception, see *Birkner v. Purdon*, 27 Mich. App. 476, 183 N.W.2d 598 (1970) (Christmas trees).

no deal, because "repaired goods" impose no out-of-pocket costs on him, he will forego the discount, which may make repair the least expensive alternative for the seller; if so, it will be chosen. In this manner, bargains optimize breach costs.¹²

A rigorous demonstration of this perhaps self-evident point, and of a cure rule's disutility, requires a detailed analysis of the several costs which breach causes, and an explanation, presented through a complex set of models, of the way in which bargaining optimizes these costs. Working through the analysis should yield a richer understanding of the subject.¹³

The primary model is the sale of a new gas range to a consumer. Upon installation, a minor defect causes the range to leak gas; as a result, the flow to burners is uncontrollable, making the appliance useless and hazardous. The buyer rejects. The market is stable in that the buyer can purchase the same range or a substantially similar one from another seller at approximately the same price.

This transaction yields four relevant cost categories. First, the seller may incur the cost of a lost sale, P.¹⁴ Second, the seller may incur the cost of replacing the range, which at least equals the costs of delivery and reinstallation, and will exceed them if the seller cannot recover the full cost to him of the "returned" item. Let this cost be R. Third, the seller may incur the cost of fixing the range, F. Finally, the buyer incurs the costs of breach, C.

Buyer cost is, in fact, the sum of several components, the value

¹² This article does not consider cases in which defects cause consequential damages. See Uniform Commercial Code § 2-715(2). Losses of this magnitude produce problems which neither § 2-508 nor § 2-608 was meant to resolve.

¹³ Readers who find the conclusions obvious need only skim section II.A to familiarize themselves with the cost categories and terminology since later sections use both. Those readers who decide to skim section II.A should take note of the glossary of symbols used in this article, provided in note 15 infra.

¹⁴ The complex components of the cost of a lost sale to a retail seller need only be briefly sketched. Let the seller repair the range and resell it as new. It is commonly thought that the seller has lost one profit, because he could have made two sales, to the rejecting buyer and to the subsequent purchaser had the first buyer accepted the goods. E.g., *Neri v. Retail Marine Corp.*, 30 N.Y.2d 393, 285 N.E.2d 311, 334 N.Y.S.2d 165 (1972). This, however, has been shown to be erroneous when the seller is in a competitive market, because in that situation sellers will expand output only until marginal revenue equals marginal cost: that is, if the maximizing point is 1,000 units, the seller will resell the rejected unit, but if there had been no rejection, he would not have made 1,001 sales for that would be inefficient. Thus, the cost of rejection is the expense of selling the same item twice; it does not include the profit of the first sale. See Comment, *A Theoretical Postscript-Microeconomics and the Lost-Volume Seller*, 24 Case W. Res. L. Rev. 712 (1973). If we assume that the seller described in the text is in a competitive market (the analysis differs unimportantly for our purposes if he is not), his cost of a lost sale is thus repair of the range and the additional selling expense. Should the defects cause him to sell the repaired range as used, his cost is thus increased by the diminution in profit. If, however, the seller may return the unrepaired range to the manufacturer, his breach cost is handling and the expense of the first sale.

of which will vary with circumstances. First, assume the seller decides, after rejection, to make no deal. The buyer must then shop for another range, incurring the cost of a second search, C_s . Second, assume the seller attempts to repair the range. If the range is imperfectly repaired but the buyer nevertheless accepts, the buyer's cost is the diminution in intrinsic worth, because the machine performs less satisfactorily, plus the cost (if any) of nonuse during the repair period. Let this diminution cost be C_1 . Third, if repair is successful with no "nonuse" cost to the buyer, costs nevertheless remain. A buyer who saw the range in a store with the nonconformities it exhibited on delivery would not pay the "new range price," despite the seller's promise to repair, since the existence of defects increases, in a concrete manner, the possibility of additional defects, thereby increasing the purchase risk. Moreover, repair means the item is no longer "new." The buyer would be purchasing a "fixed good," which is much like purchasing a used good, and the market will discount the price. Thus, there is a cost even when repair is successful, the "market discount" or "fixed good cost," which will be represented as C_2 . Fourth, some buyers may demand a "premium" in addition to the market discount (C_2). For example, assume a used range cost \$300, the new one \$350, but the "fixed" range would be valued at \$300. Repair thus shifts a buyer who is in the new goods market—a buyer who has already refused to buy a used \$300 range—into the used goods market; and the buyer may want a "premium" for being moved; concretely, he may want more than the \$50 difference in market value (C_2) to accept a "fixed" appliance. This premium, which we will call C_3 , is as much a cost of breach to the buyer as any other cost. Finally, if the seller replaces the range, the buyer incurs no search (C_s), repair (C_1), market discount (C_2), or premium costs (C_3). However, a particular buyer may be more conscious of the possibility of nonconformity after the seller has once failed; the brand may be diminished in his eyes, and the buyer may want a discount to accept replacement. Let this cost be C_r .¹⁵

¹⁵ The buyer cost categories sometimes overlap. For example, a nonfunctional defect causing a diminution in intrinsic worth, as when the range can be repaired but its looks blemished, can also be regarded as a premium discount cost. The categories are kept distinct in the text to facilitate analysis. The author is indebted to Professor Honnold for the insight, recorded in the teaching manual of his Commercial Law casebook, that a buyer who saw a defective product in a store would not pay the full price on the assurance of its perfect repair; but the author draws different conclusions from the point than does Professor Honnold. See generally J. Honnold, *Cases And Materials on the Law of Sales And Sales Financing* (3d ed. 1968).

Readers may find helpful a glossary of the symbols used herein.

P = Cost to seller of a lost sale.

R = Cost to seller of replacing a defective item.

F = Cost to seller of repairing a defective item.

Numerical values shall be arbitrarily attached to these costs to illustrate how bargaining optimizes them (any values will do but the following seem simple).

1. The range costs \$350 new. $P = \$100$; $R = \$90$; $F = \$50$. On delivery, we have assumed, the appliance is useless. The seller will initially offer to repair the range. Assuming that repair is successful without cost to the buyer, C_1 equals zero. Assume that $C_2 = \$20$; $C_3 = \$10$; $C_r = \$2$. If the range is repaired, the buyer thus incurs a cost of \$30, the market discount for a "fixed" range ($C_2 = \$20$), plus the premium for being forced to eschew a "new" item ($C_3 = \$10$). However, if the buyer accepts repair, he saves the cost of searching for a second range (C_s). Let C_s be \$5. With section 2-508 repealed, the buyer will accept repair plus a price discount of at least \$25. (This value is the sum (Σ) of $C_1 + C_2 + C_3 - C_s$; that is, $0 + \$20 + \$10 - \$5 = \25). The seller's total cost, $F + \Sigma C$, will then be between \$75 and \$80, inclusive, depending on the seller's astuteness in compelling the buyer to accept the minimum price discount. Since this cost is less than the cost of the other alternatives, a lost sale (P) or replacement (R), the seller will repair and offer a price discount. Breach cost will then be \$75 to \$80, the least expensive alternative, and bargaining prevents economic waste.

2. Assume that all costs remain constant except the cost of repair (F), which is now \$70. The seller will not repair, for the minimum cost of repair will be \$95 ($F + \Sigma C = \$70 + 0 + \$20 + \$10 - \$5(?)$). Replacement, however, will cost \$92 ($R + C_r$) and a lost sale will cost \$100 (P). Thus, the seller will supply a new range, charging the buyer \$348 (price less C_r , the discount to accept replacement). Breach cost is now \$92, but again the least expensive alternative is chosen.

3. Assume that these costs are unchanged, except that the seller's cost of a lost sale (P) is now \$65. Since replacement costs \$92 and repair costs between \$75 and \$80 the least expensive alternative is P and no sale will be made. Breach cost is now \$70 ($P + C_s$) because the buyer made one futile search, but again the parties optimized breach costs.

C_s = Cost to buyer of searching for a second item if the seller lets the initial rejection stand.

C_1 = Cost to buyer of a repaired item's diminution in intrinsic worth (if any) and the nonuse cost while the item is being repaired (if any).

C_2 = Market discount cost of a "fixed" product.

C_3 = Premium cost to a buyer of purchasing "fixed" goods.

C_r = Premium cost to a buyer of purchasing a replacement from the originally defaulting seller.

p = Probability that an item will be defective.

N = The monetary value of the risk of a defective product.

Σ = The sum, as the sum of all buyer costs is ΣC .

4. Assume that these costs are unchanged, except that the defects upon delivery are quite minor, making $C_1 = \$5$; $C_2 = \$10$; $C_3 = \$5$. This case may be the one which the critics of the perfect tender rule had in mind, for rejection apparently imposes a cost of at least \$90 (R) on the seller, while the buyer's costs of acceptance (ΣC) are \$20. However, if the buyer may reject, the seller will offer to reduce the price by \$20. The buyer should accept this offer and thus the cost to the seller of the buyer's initial rejection will be \$20, not \$90; and the perfect tender rule is plainly desirable, for no reason justifies imposing this \$20 cost on the buyer rather than the seller.¹⁶

In reality, bargains are seldom conducted with such precision, for it may be impossible or unprofitable to accurately predict the cost of alternatives, people sometimes make mistakes, and indifference can exist. But bargaining should optimize costs in this situation as well as, if not better than, in many other areas where the law does not restrict bargaining. The temptation to ignore a risk when making a sale, because it is somehow "hypothetical," is absent in this situation, for something has gone wrong; the parties here deal not in risks but in problems. Moreover, the chief impediment to achieving optimality through bargains, the parties' ignorance, is largely absent. Buyers, for example, who are left to bargain over allocating the risk of non-conformity must know, *inter alia*, the likelihood of defects and their cost. Many buyers may not know these things.¹⁷ However, buyers can approximately value their own search costs, the market value of a used item, and the premium they will charge for accepting repair or replacement. In addition, sellers will often be able to approximate the cost of the alternatives they face. Thus, bargains should optimize breach costs with reasonable precision.

B. *The Code*¹⁸

To perceive the effect of the Code, recall illustration one. Assume that: (1) after repair $C_1 = 0$ (if intrinsic worth were di-

¹⁶ The endpoint of these bargaining games is not necessarily determined exclusively by the sum of the buyer's breach costs and the seller's cost of repair, replacement or lost profit, because the buyer may demand a discount larger than his breach costs, which the seller may pay. The preceding text assumes that buyers will not so act because such assumption facilitates analysis and appears to correspond with reality. For discussion of this point and the problems resulting from possible buyer demands for "extra" compensation, see text at notes 32-33 *infra*. The textual hypotheticals involve the use case; the same factors operate respecting market fluctuation goods, except that the effect of possible price changes must also be considered. The problems they pose are discussed in Part II-B, at XXX *infra*.

¹⁷ See Schwartz, *supra* note 1, at 8, 12-18, 19-28.

¹⁸ Uniform Commercial Code § 2-508(1) creates an absolute right to cure if the seller seasonably notifies the buyer of his intention to cure and if he can do so "within the contract

minated the buyer could probably reject since section 2-508 ultimately requires "a conforming delivery"); and (2) the Code permits cure by repair alone, thus the seller need offer no price discount reflecting C_2 or C_3 . The seller will, of course, repair since the cost of repair (F) is \$50. While breach costs are \$80, approximately the result yielded by bargaining alone, the seller bears only \$50 of them (F), while the buyer bears \$30 ($C_2 + C_3$). This result is unsatisfactory for, while no economic waste exists, breach costs are imposed on the buyer for no apparent reason.¹⁹

Returning to illustration two, where all costs were the same as in illustration one except that repair cost (F) was \$70, the seller will again repair, for F is less expensive than R or P. This result is unsatisfactory for two reasons: first, the buyer again bears \$30 of breach costs, and second, the total breach cost ($F + \Sigma C$) is now \$100. Bargaining, however, would have induced the seller to replace at a total breach cost of \$92 ($R + C_r$). In this situation the Code not only imposes breach costs on the buyer unjustifiably, but also requires more economic resources to be committed to a breach than is necessary.

Thus, if the Code is read to permit sellers to cure without discounting the price to reflect market discount and premium costs, its effect is to shift those costs to buyers and, possibly, to produce economic waste. The statute, moreover, invites that construction. Section 2-508 requires the seller to "make a conforming delivery."²⁰ Section 2-106(2) provides that goods are conforming "when they are in accordance with the obligations under the contract."²¹ The seller's obligation "under the contract" may be viewed as the provision of goods which work. The statute thus suggests that if repair renders goods "conforming," *i.e.*, if the defects which were the

time" Section 2-508(2) provides that cure may be made beyond that time, again if notice is given and if "the seller had reasonable grounds to believe" that the "non-conforming tender . . . would be acceptable" The illustrations in the text presuppose that § 2-508(1) is applicable. It is assumed that the "contract time" extends for a reasonable period after delivery. See Uniform Commercial Code § 2-309(1). Buyers have a reasonable time after delivery to decide whether to accept, Uniform Commercial Code § 2-606; and with many goods performance is contemplated in that time. Cf. *Bayne v. Nall Motors, Inc.*, 12 UCC Rep. Serv. 1137 (D. Ct. Iowa 1973); *Havas v. Love*, 514 P.2d 1187 (Nev. 1973); *Zabriskie Chevrolet, Inc. v. Smith*, 99 N.J. Super. 441, 240 A.2d 195 (1968); *Bowen v. Young*, 507 S.W.2d 600 (Tex. Civ. App. 1974). The analysis is unchanged under § 2-508(2), except that this subsection arguably requires a seller to reduce the price to compensate for the costs (if any) resulting from his failure to make a conforming tender until the time for performance had expired. See *Peters*, *supra* note 9, at 212. As will appear below, § 2-508 otherwise apparently allows sellers to cure only by repair or replacement, without making recompense for any other costs their breach caused. See text at notes 20-30 *infra*.

¹⁹ Imposing these costs on the seller, on the other hand, may stimulate him to reduce defects. See text at notes 36-37 *infra*.

²⁰ Uniform Commercial Code § 2-508.

²¹ Uniform Commercial Code § 2-106.

grounds for rejection are remedied, an effective cure is made by repair alone.²²

Some cases, moreover, read the Code this way. In *Wilson v. Scampoli*²³ the buyer rejected a color television set because the picture had "a reddish tinge."²⁴ The seller offered to take the set into its shop, to repair it or, "if the set could not be made to function properly to replace it."²⁵ No mention was made of a price allowance. The buyer refused this offer because "she did not want a 'repaired set' but another 'brand new' set."²⁶ The court held for the seller, explaining:

[T]he adamant refusal . . . to allow inspection essential to the determination of the cause of the excessive red tinge to the picture defeated any effort by the seller to provide timely repair or even replacement of the set if the difficulty could not be corrected. The cause of the defect might have been minor and easily adjusted or it may have been substantial and required replacement by another new set—but the seller was never given the adequate opportunity to make a determination.²⁷

The court correctly assumed that the seller, faced with the alternatives of repair or replacement, will choose the least expensive means to cure, but it ignored the cost to the buyer of having to purchase a "repaired set." Had the buyer noticed the reddish tinge while the set was in the store, she would not have paid the full new set price for it, regardless of the seller's promise to correct the defects. Requiring the buyer to accept a repaired set if the seller determined that repair "corrected" the defects would impose an unwarranted cost on the buyer and may produce economic waste.²⁸

²² Id.

²³ 228 A.2d 848 (D.C. Ct. App. 1967).

²⁴ Id. at 849.

²⁵ Id.

²⁶ Id.

²⁷ Id. at 850.

²⁸ Some courts recognize that "fixed goods" may not conform, even if perfectly repaired, because of the insecurities which defects engender, and they permit buyers to refuse cure by repair: but only when the defects are major. One court explained that "[t]he replacement of the entire differential due to malfunction in and of itself does not constitute such a defect as would allow a refusal of repair," but allowed the buyer to refuse cure by repair because the malfunction occurred when the car was moving, thereby producing a "tremendous internal impact" which could cause the buyer to be insecure about future performance. *Bayne v. Nall Motors, Inc.*, 12 UCC Rep. Serv. 1137, 1140, 1141 (D. Ct. Iowa 1973). See also *Overland Bond & Inv. Corp. v. Howard*, 9 Ill. App. 3d 348, 292 N.E.2d 168 (1972); *Zabriskie Chevrolet, Inc. v. Smith*, 99 N.J. Super. 441, 240 A.2d 195 (1968). Cf. *Whaley, Tender, Acceptance, Rejection and Revocation—The UCC's "TARR" Baby*, 24 Drake L. Rev. 52, 58-59 (1974). The Code, however, apparently prohibits this distinction between major and minor defects. Cure is done by making "a conforming delivery." Uniform Commercial Code

Additionally, the construction of the Code by the court in *Wilson* would require buyers to accept cure by replacement alone, with no price discount for the insecurities which a prior nonconforming tender may have engendered. In *Bartus v. Riccardi*,²⁹ for example, the buyer was told, at a hearing clinic, to purchase a Model A-660 hearing aid. The seller provided a supposedly improved version, the Model A-665. The buyer claimed to have been unaware of the switch. The A-665 was unsatisfactory because it made "noise" and "gave the buyer a headache."³⁰ He returned to the clinic, "where he was informed that the hearing aid was not the model he had been advised to buy."³¹ The seller, relying on section 2-508, then offered the buyer either Model A-660 or a different A-665, but the buyer "decided that he did not want any hearing aid from the plaintiff, and he refused to accept the tender of a replacement, whether it be Model A-665 or A-660."³² The buyer also made no effort to recover his \$80 downpayment until the case was ready for trial. The court held that cure by replacement alone was proper.³³

This seems plainly wrong. A hearing aid is a serious thing; and when the seller supplies the wrong model, which is defective as well, a buyer may, as this buyer did, prefer to deal elsewhere, even at the cost of foregoing a substantial downpayment. Requiring the buyer to accept cure by replacement, with no money allowance, imposes an unjustified cost on him, and may produce economic waste.³⁴

§ 2-508(1). Minor defects may also engender insecurities, perhaps only "minor" ones. Nevertheless, if sellers may cure by repair, it is because "conforming" must mean "free of the defects that caused rejection;" insecurities are irrelevant. "Major" insecurities, attributable to major defects, must then be as irrelevant as minor ones, because "conforming" is defined as "fixed." Thus, the issue for judicial resolution is the efficacy of repair, not the nature of the defects which made repair necessary. The only way to avoid this result, that sellers may always cure by repair, is to hold that buyers may always refuse cure by repair, because repaired goods cannot be "conforming" if they engender any insecurities. The distinction between major and minor defects is not only prohibited by the Code, but is also unprincipled. All defect-engendered insecurities are translatable into money and are thus costs to buyers of defective goods. The cases provide no principle which justifies making buyers bear "minor" costs but not "major" ones. Of practical significance, the cases also offer no principle by which the distinction between major and minor costs can conveniently be drawn, which makes a rule turning on that distinction of dubious utility.

²⁹ 55 Misc. 2d 3, 284 N.Y.S.2d 222 (Utica City Ct. 1967).

³⁰ Id. at 4, 284 N.Y.S.2d at 223.

³¹ Id.

³² Id. at 5, 284 N.Y.S.2d at 223.

³³ Id. at 7, 284 N.Y.S.2d at 225.

³⁴ See also *Traynor v. Walters*, 342 F. Supp. 455 (M.D. Pa. 1972), where the seller made two partially defective shipments of Scotch Pine trees, the buyer refused to take a third shipment and the court held that the third offer, since it was timely, was a conforming delivery and an effective cure. Id. at 460-61. Pre-code law is preferable, since it allowed a buyer to refuse further deliveries if one was defective, although a buyer could not refuse a later shipment of similar goods, if it was tendered under a separate contract. American Paper

These cases are defensible only on the ground that buyers must bear market discount and premium costs. Yet sellers offer more than machines; they sell myths of power, prestige and success. Some buyers purchase the myth along with the product; they pay for that myth and sellers take their money in return for it. Defects sometimes destroy it, though the product be perfectly repaired; if so, the product is worth less, at times in the market's judgment and at other times in the judgment of particular buyers who especially cared for "newness." No principle distinguishes these costs from others which sellers cause, and which sales law does not require buyers to bear.³⁵

A pragmatic distinction lies in a supposed possibility that buyers may willfully overstate partly unprovable costs,³⁶ either to avoid transactions entirely or to extort excessive price discounts. The probabilities and dangers of such bad faith will be discussed later. At this point, however, it can be said that when buyers are in good faith, section 2-508 is unnecessary to prevent economic waste, invites its production and makes possible the unjustified imposition of breach costs on buyers. An alternative to repealing section 2-508 would be to construe or amend it to require sellers who cure to give appropriate price discounts. But it is pointless to make the Code do what the parties themselves can accomplish by bargaining. Section 2-508, in its present form or amended, can be supported only by the goal of avoiding bad faith rejections.³⁷

& Pulp Co. v. Denenberg, 233 F.2d 610 (3d Cir. 1956); Ten Broeck Tyre Co. v. Rubber Trading Co., 186 Ky. 526, 217 S.W. 345 (1920). See also Jerome Hardwood Lumber Co. v. Beaumont Lumber Co., 157 Ark. 220, 247 S.W. 1059 (1923); Rock v. Gaede, 111 Kan. 214, 207 P. 323 (1922); Nicholson v. American Hide & Leather Co., 307 Mass. 456, 30 N.E.2d 376 (1940). The Code explicitly changes this law for installment contracts. Uniform Commercial Code § 2-612.

³⁵ Professor Llewellyn perhaps perceived aspects of this point, for he once said: "Rescission for minor defect is, however, essentially an ultimate consumer's remedy: it fits the case of the wallpaper which is just enough off-color, or the radio which is just enough off true to edge the nerves." Llewellyn, *On Warranty of Quality, and Society*: II, 37 Colum. L. Rev. 341, 388 (1937). Early drafts of the Code, in which Llewellyn extensively participated, apparently limited cure to transactions between merchants. See note 37 *infra*.

³⁶ C₂, the market discount, will often be objectively verifiable.

³⁷ Under pre-code law, a buyer could reject if the seller breached a warranty and the property in the goods had not passed, and could rescind if the property had passed. See Uniform Sales Act §§ 69(1)(c) & (d). What then happened respecting cure is confused. One commentator asserted that if the contract time had not expired and the buyer had not changed his position, the seller probably could cure. Note, 31 Colum. L. Rev. 1005 (1931). A comment to perhaps the earliest draft of the Code, apparently written by Llewellyn, stated: "The case-law on cure of defective tender is in utter confusion . . . ;" and the draft then sought to reproduce the commentator's version of the law. Proposed Report On and Draft of a Revised Uniform Sales Act § 42-A, Comment (1941 Mimeo) [hereinafter cited as 1941 Code]. This draft also created a substantial performance rule, but only in sales between merchants and not in sales of machinery, on the ground that such was mercantile custom. Id. § 11(2)(a), Comment 1. By 1943, this rule was deleted and the seller's right to cure put in substantially modern form, but the draftsmen unfortunately never explained the changes. E.g., Uniform Commercial Code, Revised Uniform Sales Act, Third Draft § 77 (1943) [hereinafter cited as

The next section of this article will examine buyer bad faith in both the use goods and market fluctuation goods context. This examination will show that buyer bad faith is not sufficiently troublesome to justify a cure rule.

III. BUYER BAD FAITH

Buyers sometimes reject for reasons other than the non-conformities which the goods exhibit. The issue is whether the gains from preventing such rejections outweigh the costs of a cure rule. Inferences drawn from plausible models of buyer behavior and the scanty available data strongly suggest that those gains are insufficient to support the continuation of a cure rule.

A. *The Use Case*

The initial model is a machine purchased by a business for use in manufacturing operations. Short run price changes for machines of this kind are negligible. Assume that the machine is delivered with slight but quickly repairable defects so that C_1 will be zero.

Two supposedly common motives for rejection are that a substantially similar machine can be purchased elsewhere for less, or that a better brand appears on the market. Several factors make such rejections rare. First, the buyer must incur the expense of making two deals. If he has particular requirements, such as a machine to perform a specialized operation, the expense of satisfying those requirements twice may be substantial. This occurs either because: (1) finding nonstandard goods will often require more searching than finding standard goods; or (2) negotiating to have goods made or modified to meet special needs is expensive. Thus, many buyers will stop looking after the initial purchase. Second, goodwill is an asset the loss of which is a cost to the buyer. Rejection for trivial defects may damage a buyer's reputation. Third, it is probable that the first purchase was profitable or it would not have been made. Thus, the bad faith buyer would not be attempting to avoid a losing transaction, but to convert a good deal into a better one. The gains from a second purchase are unlikely to outweigh the costs of making two purchases and losing goodwill, unless the second machine sells for substantially less or the new

1943 Code]. It has been claimed that sellers, operating against the confusing background of pre-code law, often contracted for a right of cure. E.g., 3 S. Williston, *The Law Governing Sales of Goods at Common Law and under the Uniform Sales Act* §§ 491, 611a., at 65-66, 361-62 & nn. 15, 19 (1948 ed.); Note, 31 Colum. L. Rev. 1005, 1013 (1931); Note, 28 Colum. L. Rev. 466 (1928). For cases litigating such contracts, see, e.g., *Hudson Rug Refinishing & Cleaning Corp. v. Prime Mfg. Co.*, 115 F.2d 615 (7th Cir. 1940); *Troendly v. J. I. Case Co.*, 51 Idaho 578, 8 P.2d 276 (1932); *J. I. Case Threshing Mach. Co. v. Dulworth*, 216 Ky. 673, 287 S.W. 994 (1925).

brand is significantly better. The price differential should seldom be sufficiently large since the original sale reflected some searching of alternatives. Although buyers lack perfect knowledge, they will seldom miss unusually attractive deals. Similarly, radical innovation which becomes manifest in the short interval between purchase and delivery is rare.

This analysis also holds for consumer sales. Computerized information processing respecting consumers is becoming common, and it facilitates the conversion of good faith purchase behavior into an asset, the loss of which would be a cost to the consumer. Additionally, consumer goods come in such a large number of models and with such a variety of options that the search costs of making two deals could often be significant. Finally, as in the commercial situation, the first purchase would normally have been profitable and the gains to be derived from a second purchase would often be small. Thus, rejection for trivial defects because a better deal can be made later is apparently an unusual phenomenon. Significantly, bad faith rejections rarely appear in cases involving use goods, whereas such rejections do appear in the market fluctuation context.³⁸

However, a perfect tender rule also makes extortion possible. To illustrate the "innocent" version, we shall make the model used in illustration one more realistic. In illustration one, $P = \$100$; $R = \$90$; $F = \$50$; $C_1 = 0$; $C_2 = \$20$; $C_3 = \$10$; $C_s = \$5$; $C_r = \$2$; section 2-508 is repealed. The bargaining end point is, in fact, indeterminate. The seller can repair (F) at a cost of \$50 and will reduce the price no more than \$41, because the cost of F plus the accompanying price reduction must be less than \$92, the cost of replacement ($R + C_r$). The buyer incurs breach costs of \$30 ($C_2 + C_3$) and will not accept a price reduction of less than \$25, the sum of breach costs less the search cost saved by repair (C_s).

Assume that the buyer, either maliciously or as a bargaining gambit, demands a price reduction of \$40. The seller can roughly value C_1 and C_2 , in that he can estimate the cost of repair and the market discount of a fixed good; thus, he knows that $C_1 + C_2 = \$20$. He does not know C_3 , for the premium is personal to each buyer, and he does not know C_s , for search costs are a function, *inter alia*, of the value each buyer assigns to his own time. The seller will perceive the possibility that $C_3 - C_s = \$20$ (in fact it equals \$5). He may then counter with a price reduction of \$33 which the buyer will certainly accept, since his total cost is \$30. This endpoint is unsatisfactory for two reasons: first, breach cost is \$83

³⁸ See authorities cited in notes 41, 47 *infra*.

when it should be \$80, and therefore \$3 of waste is produced, and second, the seller is penalized those \$3, yet buyers can obtain only compensatory damages for breach of sales contracts.³⁹

The possibility of this troublesome result is nevertheless preferable to a cure rule. Of the three choices—no sale, replacement or repair—bargaining will, as it did in the model, produce the result with the lowest cost. This the current Code cannot ensure. In addition, the Code forces buyers to bear some breach costs. Allowing bargains to operate freely will cause some sellers to bear costs in excess of actual damages. If someone must bear a penalty, it would seem preferable to penalize sellers rather than buyers because the penalty increases the incentive to avoid defects and at this, sellers usually have a comparative advantage. In other words, the penalty is more likely to produce a desirable outcome if it is imposed on sellers.

Moreover, penalties should occur infrequently because buyers will generally concentrate on recovering only the costs which produced rejection. The diminution in intrinsic worth and market discount costs are often at least approximately verifiable. It is the premium discount and search costs which are personal to buyers, and thus subject to extortionate manipulation. The premium cost is primarily incurred by consumers, who seem more susceptible to "sentimental" or "non-economic" purchase motivations. Yet consumers will usually lack the sophistication needed to manage complex extortionate bargains. Business buyers, on the other hand, will have less incentive to act in this manner because C_3 is not a significant cost for them. Moreover, these buyers are aware that their sellers can approximately value C_1 and C_2 , and are also aware of their sellers' knowledge that premium and search costs are susceptible to manipulation. Buyer insistence on a price discount significantly in excess of C_1 and C_2 may thus produce suspicion, acrimony and a loss of goodwill. Businessmen will, therefore, be more likely to understate rather than overstate the premium discount. Finally, extortion is immoral, which for many people is a sufficient deterrent.

A second form of extortion may arise in the sale of a specialized machine. Assume the original price of the machine is \$10,000; the cost of defects to the buyer, after repair, is \$600 but because the machine is specialized the resale value is \$4,000. The buyer rejects but offers to repurchase for \$5,000. The seller's loss if he refuses is \$6,000, but if he accepts his loss is \$5,000. Should he accept, we have the economic waste and penalty noted above.

³⁹ Uniform Commercial Code §§ 2-711 to -15. See also Simpson, *Punitive Damages For Breach of Contract*, 20 Ohio St. L.J. 284 (1959).

Again, however, several factors indicate that this will rarely occur. First, if the machine is specialized, the buyer will have incurred large search costs. Should the rejection-repurchase gambit fail, he may have to incur them again. Second, it may fail because some sellers will not limit their cost comparisons to resale and repurchase prices, but will also consider the gains to be derived from establishing the principle that such actions will not succeed. The knowledge that sellers may so act will deter some buyer bad faith of this kind. Third, extortion is immoral. Fourth, in this case the seller knows what the buyer is attempting; thus, the buyer will certainly incur goodwill costs. Buyers often expect to make more than one purchase and are not aided by the possession of a bad name. Fifth, the original sale must have been profitable. Most buyers will probably not run the substantial risks which extortion poses in an attempt to convert good deals into windfalls.

Thus, like rejection for a better deal, extortion should be an uncommon phenomenon in the use case. Moreover, the value of a risk is the product of its likelihood (here small) and the costs it imposes. When bad faith rejections could impose large enough costs to make the risk of them financially significant, sellers can contractually avoid the risk. Specifically, when rejection of an expensive, specialized machine will create enormous costs, sellers apparently contract for a right to cure.⁴⁰

B. *The Market Fluctuation Case*

It has been demonstrated that the costs incurred by buyers who reject in bad faith are likely to outweigh the gains derived from such rejections in markets where prices are stable, particularly when the goods are also to some extent tailored to particular needs. However, when identical goods can be purchased from any seller, and the goods need not be modified, the search costs of making two deals are greatly reduced since, for example, a second order can be made by phone. In addition, if the price of the goods drops radically between sale and delivery, avoiding the deal may be profitable. Thus, there is a danger of bad faith rejections in markets for

⁴⁰ Repair and replacement clauses are standard in sales of machinery. See Schwartz, *supra* note 1, at 17 n.16. "Extortion," as used here, means to impose costs on a party which he did not agree to bear. Buyers, then, extort when they obtain price reductions in excess of the costs which breach imposed on them. Sellers also extort, with the assistance of the Code, when they impose breach costs on buyers. The cost to the seller of extortion seems limited to the loss of goodwill; but sellers may minimize this by explaining to buyers that they are doing no more than the law allows. The possible efficacy of this explanation, the encouragement which the Code gives, and the absence of other costs all suggest that extortion, in the sense used above, is less risky for sellers than for buyers and will, therefore, be done more frequently by sellers.

standard goods which can experience large, short-term price swings. Markets in commodities, raw materials and agricultural products best fit this pattern.⁴¹

Two factors combine to minimize the danger of bad faith rejections in these markets: first, the risk of rejections induced by price fluctuations is obvious to sellers; and second, contractual avoidance of such risks is relatively simple. The cases, unsurprisingly, evidence a variety of contractual solutions to the rejection problem. Some contracts set the price as that prevailing in an established market at the time of performance;⁴² others use liquidated damage clauses tied to the market price, such that if price falls, buyers who reject must pay the difference between the price at the time the contract was made and the price at the time of rejection.⁴³ Such

⁴¹ The only cases found, for example, in which buyers attempted the "rejection-repurchase for less" gambit involved such markets. The sellers refused and successfully sued. *C. C. Mengel & Bro. Co. v. Handy Chocolate Co.*, 10 F.2d 293 (1st Cir. 1926), cert. denied, 271 U.S. 668 (1926) (cocoa); *Cobb Lumber Co. v. Sunny S. Grain Co.*, 36 Ga. 140, 135 S.E. 759 (1926) (feed-stuff); *McNeff v. White Eagle Brewing Co.*, 294 Ill. App. 37, 13 N.E.2d 493 (1938) (hops); *Fielding v. Robertson*, 141 Va. 123, 126 S.E. 231 (1925) (cottonseed meal). But cf. *Cain v. Grosshans & Peterson, Inc.*, 196 Kan. 497, 413 P.2d 98 (1966).

For other illustrations of cases in which market fluctuations were sufficiently important to be noted, see, e.g., *LeRoy Dyal Co. v. Allen*, 161 F.2d 152 (4th Cir. 1947) (potatoes); *Sloss-Sheffield Steel & Iron Co. v. Stover Mfg. & Engine Co.*, 37 F.2d 876 (7th Cir. 1929) (pig iron); *Cub Fork Coal Co. v. Fairmont Glass Works*, 33 F.2d 420 (7th Cir. 1929) (coal); *Buchman v. Millville Mfg. Co.*, 17 F.2d 983 (2d Cir. 1927) (cottonyarn); *Higgins v. California Prune & Apricot Growers, Inc.*, 16 F.2d 190 (2d Cir.), cert. denied, 273 U.S. 781 (1926) (dried prunes); *Griffin Grocery Co. v. Richardson*, 10 F.2d 467 (8th Cir. 1926) (sorghum); *Erie Food Prods. Co. v. Interocean Mercantile Corp.*, 299 F. 71 (6th Cir. 1924) (sugar); *Garcia & Maggini Co. v. Washington Dehydrated Food Co.*, 294 F. 765 (9th Cir. 1924) (evaporated apples); *Rand v. Morse*, 289 F. 339 (8th Cir. 1923) (rice); *A. Klipstein & Co. v. Dilsizian*, 273 F. 473 (2d Cir. 1921) (gum arabic); *Cossins v. Herschel Cal. Fruit Prods. Co.*, 103 Cal. App. 524, 284 P. 1038 (1930) (tomatoes); *Consolidated Flour Mills Co. v. Di Marco*, 18 La. App. 292, 136 So. 657 (1931) (flour); *Wehmeier v. Youtz*, 215 Mo. App. 240, 256 S.W. 145 (1923) (hogs); *Planters Nut & Chocolate Co. v. Douglas Candy Co.*, 240 S.W. 473 (Mo. App. 1922) (peanuts); *Mercer Tube & Mfg. Co. v. American Zinc Sales Co.*, 258 App. Div. 506, 17 N.Y.S.2d 132, aff'd, 284 N.Y. 636, 30 N.E.2d 491 (1940) (zinc); *Otto Seidenburg, Inc. v. Tautfest*, 155 Ore. 420, 64 P.2d 534 (1937) (hops); *Fielding v. Robertson*, 141 Va. 123, 126 S.E. 231 (1925) (cottonseed meal). But see *Forsyth Furniture Lines, Inc. v. Druckman*, 8 F.2d 212 (4th Cir. 1925) (signs of an approaching collapse in the furniture market, but probably caused by depression of 1920).

⁴² E.g., *Louisville Soup Co. v. Taylor*, 279 F. 470 (6th Cir. 1922) (price was \$.50 per 280 lbs. over the official closing market price at Savannah on date seller received order); *Maxwell Planting Co. v. A.P. Loveman & Co.*, 212 Ala. 293, 102 So. 45 (1924); *Beyer v. Saginaw Creamery Co.*, 358 Mich. 284, 100 N.W.2d 441 (1960); *Planters Nut & Chocolate Co. v. Douglas Candy Co.*, 240 S.W. 473 (Mo. App. 1922); *Buret v. Vogelstein & Co.*, 188 App. Div. 605, 177 N.Y.S. 402 (1919).

⁴³ One such contract, for the sale of flour, provided that if the buyer refused to send shipping instructions, the seller could terminate and recover the carrying cost and selling cost: [P]lus or minus the difference between the market value of a bushel of cash wheat at mill on the date of sale and on the date of termination, multiplied by 4.6 times the number of barrels of flour. This amount is to be added if the price of cash wheat is lower, and subtracted if the price of cash wheat is higher, upon the date of termination.

clauses make explicit the contract's risk shifting function, as well as the seller's intention to hold the buyer to his obligations. In other cases the parties treat the risk of bad faith rejection directly. Sales contracts create a discount for particular quality defects, thereby impliedly requiring acceptance;⁴⁴ provide for substantial performance with permissible variations;⁴⁵ make an inspection certificate of a third party conclusive respecting performance;⁴⁶ or explicitly eliminate or limit the right of rejection.⁴⁷

However, the cases only indicate what some parties do, not what most of them do. Professor Honnold, some years ago, surveyed the rules of certain commodities exchanges, finding that price adjustment, rather than rejection, was the standard remedy for quality defects.⁴⁸ An examination of the rules of some of those exchanges, along with certain other exchanges, revealed a variety of solutions to the bad faith rejection problem. Almost all exchanges set quality standards with permissible variations.⁴⁹ Many exchanges

Colorado Milling & Elevator Co. v. Rapides Grocery Co., 142 So. 626, 627 (La. App. 1932). See also Russell Miller Milling Co. v. McLean, 48 S.D. 198, 203 N.W. 498 (1925).

⁴⁴ E.g., Apex Mining Co. v. Chicago Copper & Chem. Co., 306 F.2d 725 (8th Cir. 1962); Eugene B. Smith & Co. v. Russek, 212 F.2d 338 (5th Cir. 1954) (custom read into contract); Memhard v. Alfred Gabrielsen Co., 224 Ky. 238, 5 S.W.2d 1070 (1928) (custom read into contract); Swift & Co. v. New Roads Oil Mill & Mfg. Co., 148 La. 1009, 88 So. 250 (1921).

⁴⁵ E.g., Baer Bros. Land & Cattle Co. v. Reed, 197 F.2d 569 (10th Cir. 1952); Western Elec. Co. v. Williams Sales Co., 236 F. Supp. 73 (M.D.N.C. 1964); Thach v. Durham, 120 Colo. 253, 208 P.2d 1159 (1949); Gile v. Tsutakawa, 109 Wash. 366, 187 P. 323 (1920).

⁴⁶ E.g., Bartlett & Co. v. Grain Merchants Co. 323 F.2d 501 (5th Cir. 1963); Rand v. Morse, 289 F. 359 (8th Cir. 1923); Texas Star Flour Mills Co. v. Moore, 177 F. 744 (W.D. Mo. 1910); Hind v. Willich, 127 Misc. 355, 216 N.Y.S. 155 (S. Ct. 1926); Stone v. Blue Ridge Tie Co., 7 Tenn. App. 670 (1927).

⁴⁷ E.g., Schuman Co. v. Nelson, 219 F.2d 627 (3d Cir. 1955); LeRoy Dyal Co. v. Allen, 161 F.2d 152 (4th Cir. 1947); Continental Forest Prods., Inc. v. White Lumber Sales, Inc., 256 Ore. 466, 474 P.2d 1 (1970).

An additional deterrent to rejecting for minor quality defects is that when courts believe that the actual case of rejection is market decline, buyers generally seem to lose. E.g., Griffin Grocery Co. v. Richardson, 10 F.2d 467 (8th Cir. 1926); Colorado Milling & Elevator Co. v. Rapides Grocery Co., 142 So. 626 (La. App. 1932); Consolidated Flour Mills Co. v. DiMarco, 18 La. App. 292, 136 So. 657 (1931); Otto Seidenberg, Inc. v. Tautfest, 155 Ore. 420, 64 P.2d 534 (1937); Rector v. DeArana, 398 S.W.2d 911 (Tex. 1966). Buyers do no better, in the context of a market decline, when they raise trivial objections to the manner of tender or fail to send shipping instructions. E.g., Erie Food Prods. Co. v. Interocean Mercantile Corp., 299 F. 71 (6th Cir. 1924); Colonial Ice Cream Co. v. Interocean Mercantile Corp., 296 F. 316 (3d Cir. 1924); Garcia & Maggini Co. v. Washington Dehydrated Food Co., 294 F. 765 (9th Cir. 1924); Rand v. Morse, 289 F. 359 (8th Cir. 1923); A. Klipsteins Co. v. Dilsizian, 273 F. 473 (2d Cir.), cert. denied, 257 U.S. 639 (1921); Mathieu v. George A. Moore & Co., 4 F.2d 251 (N.D. Cal. 1925), aff'd, 13 F.2d 747 (9th Cir.), cert. denied, 273 U.S. 733 (1926). See also authorities cited in note 41 supra; Eno, Price Movements and Unstated Objections to the Defective Performance of Sales Contracts, 44 Yale L. J. 782 (1935). But the costs of litigation and the frequent great geographical separations between buyers and sellers reduce the deterrent effect of law suits.

⁴⁸ Honnold, supra note 8, at 464-65 & n.35.

⁴⁹ For example, a satisfactory delivery of frozen pork bellies on the Minneapolis Grain

explicitly establish price discounts for grade variations.⁵⁰ Almost all provide for "official inspections" by federal or other designated officials respecting quality and weight, with sales made conditional upon receipt of inspection certificates. In some cases these certificates are conclusive as to quality,⁵¹ while in other cases a party may call for "reinspection," which is done promptly by experts whose decision is final.⁵² Commodities contracts also often explicitly limit or preclude rejection.⁵³ Business buyers sometimes hedge against the risk of price fluctuation.⁵⁴

Thus, bad faith rejections in the fluctuating market case apparently occur only in unusual situations. A use goods market, for example, may be converted into a fluctuating goods market by war,

Exchange must "show 31 or less minor defects," which are explicitly defined. Rules and Regulations of the Minneapolis Grain Exchange, Rule 1704 [hereinafter cited as Minneapolis]. See also American Cotton Waste Exchange, Trading Rules, Article II, §§ 1-9 [hereinafter cited as American]; Rules and Regulations of the Chicago Board of Trade, e.g., Rules 291, 903, 919, Regulations 1148, 1479, 1576-84, 8001, 8020 [hereinafter cited as Chicago]; Rules of the Chicago Mercantile Exchange, Rules 1203-04, 1301, 1304, 1604, 1901, 1904, S 1301-02 [hereinafter cited as Chicago M.]; Rules And Bylaws of The Dallas Cotton And Commodity Exchange, Rules for Arbitration and Appeal IV(d), (g), Trade Rules 6, 8 [hereinafter cited as Dallas]; Greenwood Cotton Exchange, Rules 18, 30 [hereinafter cited as Greenwood]; Minneapolis, supra, Rule 1002, Regulation 2019; New York Mercantile Exchange, Revised Maine Potato Futures Contract §§ 51.03-.04 [hereinafter cited as NYME Potato]; New York Mercantile Exchange, Information And Rules In Brief [hereinafter cited as NYME] Silver Coin Futures 3; Platinum Futures 4; Palladium Futures 2; Imported Frozen Fresh Boneless Beef Futures 4-5; By-Laws And Rules, Commodity Exchange, Inc., New York City, By-Laws §§ 912-15, 927, 986 [hereinafter cited as Comm. N.Y.].

⁵⁰ Chicago, supra note 49, e.g., Rules 283(d), 293, 294, Regulation 1104(3); Chicago M., supra note 49, e.g., Rules 1204(B)(C), 1304(B), 1604(B), S 1303; Comm. N.Y., supra note 49, By-Laws §§ 932(h), 947(g); Minneapolis, supra note 49, Rule 1003; NYME, supra note 49, at 4-5; Constitution Rules and Regulations of The St. Joseph Grain Exchange, Article XVIII, § 11 [hereinafter cited as St. Joseph].

⁵¹ NYME Potato, supra note 49, § 51.14. See also NYME, supra note 49, Platinum, at 6; Palladium, at 4.

⁵² E.g., Chicago, supra note 49, Rule 344, Regulations 926-27, 1104(1)(a); Chicago M., supra note 49, Rule 1905; Comm. N.Y., supra note 49, By-Laws §§ 932(h), 947(g); Minneapolis, supra note 49, Rule 1316; St. Joseph, supra note 50, Article XVIII § 20.

⁵³ For example, the New York Mercantile Exchange provides that, in sales of imported, frozen, fresh, boneless beef futures, "any buyer who fails to accept delivery pursuant to Exchange By-Laws and Rules shall be in default. . . ." NYME, supra note 49, Beef, at 10. Accord, *id.*, Platinum, at 6; Palladium, at 4; Silver Coin, at 7; NYME Potato, supra note 49, § 51.13(a). See also Greenwood, supra note 49, Rules 16, 19, 20, 32; American, supra note 49, Article III, § 3.

⁵⁴ Commodities exchanges sometimes provide for compulsory arbitration of disputes under sales contracts between members. E.g., Dallas, Rules For Arbitrations And Appeals, supra note 49, I; Minneapolis, supra note 49, Rule 600; St. Joseph, supra note 50, Article VIII § 3. In addition, the rules of the New York Mercantile Exchange provide that if a buyer refuses to take delivery, the President or his agent shall sell in the cash market the goods the buyer refused, hold the buyer for the difference between the delivery price and the amount received, and charge the buyer a penalty of at least \$100 per contract plus brokerage and expenses. If the buyer is judgment proof, the clearing house is liable to the seller for any loss sustained. E.g., NYME, supra note 49, Beef, at 11; Platinum, at 7. Other exchanges have similar rules. See Chicago M., supra note 49, Rules 1109, S 1311; Comm. N.Y., supra note 49, By-Laws §§ 406, 932(h), 947(g).

peace or depression,⁵⁵ or an ignorant seller entering into contracts not regulated by a commodity exchange may fail to protect himself. Ignorance, however, is apparently decreasing in recent years; Sales Act cases in the period 1936-56 indicate a decline in bad faith rejections, and since 1956 few examples exist.⁵⁶

C. *The Choices*

In summary, a cure rule is unnecessary to avoid economic waste when buyers act in good faith, since bargaining will optimize breach costs. Moreover, the Code as currently written invites courts to impose breach costs on buyers unjustifiably and to produce the economic waste it is intended to avoid. When buyers act in bad faith, however, limitations on their right to reject will prevent some

⁵⁵ This may have occurred in *Virginia Shipbuilding Corp. v. United States Shipping Bd.*, 292 F. 440 (E.D. Va. 1923), *aff'd*, 22 F.2d 38 (4th Cir. 1927). The company, on December 7, 1917, agreed to build cargo ships for the Government. By September 25, 1919, the ships' value had increased greatly because "freight rates were at their peak, and the government had already discontinued its shipbuilding policy." 292 F. at 453. The company then agreed to repurchase the ships. Prices, however, soon thereafter rapidly declined, apparently as a result of generally depressed conditions in the war's aftermath, so that by the spring of 1921 the ships "were a drug on the market, and could not be profitably operated at all . . ." *Id.* The company unsuccessfully refused to comply with the repurchase agreement. See also *Forsyth Furniture Lines, Inc. v. Druckman*, 8 F.2d 212 (4th Cir. 1925). A somewhat different example of an unanticipated disaster is given in *Denison Mines, Ltd. v. Michigan Chem. Corp.*, 469 F.2d 1301 (7th Cir. 1972). A buyer of "yttrium oxide," which it refined and resold for use in color television tubes, made an apparent (and unsuccessful) bad faith rejection "because of technological changes in the television industry [which caused] the demand for the refined product [to] evaporate." *Id.* at 1303. These changes seemed sudden and unanticipated. Finally, although the large number of bad faith rejections in the sugar cases in the early 1920's appear to contradict my thesis, because sugar is known to fluctuate in value, those rejections also resulted from extraordinary events. The dislocations in sugar markets produced by the First World War and its aftermath led to "the most violent price decline ever recorded in sugar . . .," which neither sellers nor buyers anticipated. Case study, *Cancellation*, 2 *Harv. Bus. Rev.* 496, 498 (1924).

⁵⁶ Apart from *Denison Mines Ltd. v. Michigan Chem. Corp.*, 469 F.2d 1301 (7th Cir. 1972), research unearthed only two cases in which, against falling markets, buyers sought to avoid deals on the ostensible ground of quality defects. *American Produce Co. v. Marion Creamery & Poultry Co.*, 214 Ore. 103, 327 P.2d 1104 (1958); *Rector v. DeArana*, 398 S.W.2d 911 (Tex. 1966). But in neither case was there any evidence of bad faith except the market decline itself, and both buyers lost.

The decline in bad faith rejection cases may be attributable to the increased use of contracts regulating rejection or the Code, which creates a right of cure. The former is probably the cause. The decline in cases between 1936-56 cannot be attributed to the Code. Moreover, as Professor Honnold has pointed out, cure is no help to a distant seller when his buyer rejects on a falling market—the most troublesome case—since the market decline requires cure to be made rapidly, but the distance precludes this. Honnold, *supra* note 8, at 424. Such statutes as the Perishable Agricultural Commodities Act, 7 U.S.C. §§ 499a, *et seq.* (1970), passed in 1930, which authorizes the Secretary of Agriculture to adjudicate contract disputes involving many agricultural products and encourages sellers to preclude rejection by contract, and the growing commercial sophistication of sellers, as reflected in the commodities rules cited in notes 49-54 *supra*, seem the more likely cause of the decline in cases. The earliest draft of § 2-508 was almost entirely concerned with bad faith rejection on a falling market. 1941 Code, *supra* note 37, § 42-A, Comment A. See also *Handbook Of The National Conference On Uniform State Laws And Proceedings* 176 (1943). The current cure rule may be medicine for a disease which has largely disappeared.

economic waste. But bad faith is rare and partially avoidable by contract in the use goods market; and an obvious danger which is almost completely avoidable by contract in the market fluctuation case. This suggests four possible changes: (1) repeal section 2-508; (2) amend section 2-508 to provide that a seller may cure only if he gives an appropriate price discount;⁵⁷ (3) limit the application of section 2-508 to the situation where buyer bad faith is shown; or (4) limit the application of section 2-508 to the market fluctuation case, where bad faith rejections may present a serious problem. An analysis of the last three alternatives should indicate the desirability of the first.

The advantage of requiring appropriate price discounts is that the Code, in theory, will then approximate the results of bargaining when buyers are in good faith, and will ameliorate the results of bad faith. The relevant cost calculations, however, will be quite difficult to make. Recall illustration one above, where price = \$350; P = \$100; R = \$90; F = \$50; C₁ = 0; C₂ = \$20; C₃ = \$10. Assume the seller offers to repair and reduce the price by \$10, the buyer refuses, and the seller sues. The case could present the following factual issues: (1) the seller claims that C₂, the market discount, is actually \$10; (2) the seller claims that C₃, the premium to buy a "fixed good," is actually zero, but the buyer is practicing extortion; (3) the buyer claims that replacement cost is actually \$40, and he is entitled to a new range; (4) the buyer claims that repair cost is actually \$30, but the seller is surreptitiously shifting breach costs to him. The complexity of these issues may result in time consuming and costly litigation. Indeed, the expense of litigation may outweigh the possible gains, so that the parties will either forego it or not adequately develop their case. Should the latter occur, the price discount set by the court may be arbitrary. Moreover, the results of litigation will often be unpredictable at the time the rejection decision must be made. The buyer will probably be ignorant of the seller's costs; the seller cannot be sure of a court or jury's ability to distinguish

⁵⁷ Professors White and Summers suggest that § 2-508 should be read to permit sellers to cure by giving a price allowance, although they concede that this does "modest violence . . . to the language . . ." because businessmen allow such cures. White & Summers, *supra* note 8, § 8-4, at 269. Although some businessmen do so, the fact cannot, of itself, support the conclusion that the Code should make the option available in all contexts. This author contends that a mandatory price discount rule would be unwise. See text at notes 57-58 *infra*. Moreover, allowing cure by price allowance is unlikely to have been the draftsmen's intention, and pre-Code law seems contrary. The Second Circuit once remarked:

We know of no rule of law which justifies the position taken below that merchandise which is unmerchantable must be accepted by the buyer, if an allowance be granted on the purchase price. The goods tendered are either merchantable or unmerchantable, and if they be unmerchantable, it is not a delivery within the requirements of the contract.

In *re* A.W. Cowen & Bros., Inc., 11 F.2d 692, 694 (2d Cir. 1926).

between a good faith request for a premium discount and an attempt at extortion; and so forth. An important function of sales law is to provide the parties with clear guidance as to what they can and cannot do. A price discount rule will probably do the contrary.

A similar argument may be made against limiting the application of section 2-508 to the situation where the buyer acts in bad faith. The problem for a court is to distinguish bad faith from good, and for the parties to know the bases on which a court will draw such a distinction. Both will be quite difficult and, therefore, a rule turning on the distinction would be undesirable.

Limiting cure to the market fluctuation case is also unsatisfactory. The parties must be notified in advance into which category they fall. Incorporating a list of markets into the Code seems cumbersome and inflexible. Advance notification, moreover, will not resolve a substantial number of cases, for bad faith rejections seem troublesome primarily when a normally stable use goods market is converted into a fluctuating market by the pressure of extraordinary events which are seldom foreseeable.

Moreover, a cure rule may be inappropriate for market fluctuation rejections. In many cases an unforeseen risk will have materialized, creating a situation in which amicable resolution is impossible. Such cases, reflecting a breakdown of normal commercial dealings, should be handled by reference to current conceptions of morality as applied to the parties' peculiar circumstances. No specific rule, such as that requiring cure, will always be appropriate because of the impossibility of visualizing, when the rule is created, many of the situations to which it is to apply. Section 1-103 states that, unless the Code provides otherwise, "the law merchant . . . shall supplement its provisions."⁵⁸ Use of that amorphous concept to modify the perfect tender rule should produce wiser solutions to those bad faith rejection problems than those reached under section 2-508.⁵⁹

⁵⁸ Uniform Commercial Code § 1-103.

⁵⁹ Recourse to the "law merchant" gives a seller against whom a rejection has been made little guidance as to his chances in a lawsuit, but at least the parties know rejection is permissible. Also, when catastrophe occurs, giving the courts flexibility would appear to be the wisest course.

Section 2-612, concerning installment contracts, also modifies the perfect tender rule. Section 2-612(2) authorizes buyers to reject a non-conforming installment only if "the non-conformity substantially impairs the value of that installment and cannot be cured" However, buyers must nevertheless accept if "the seller gives adequate assurance of [the defect's] cure" How a seller may give "adequate assurance" that he will cure a non-conformity which "cannot be cured" is unexplained. Furthermore, § 2-612 requires buyers to accept defective tenders, and this cannot be justified by any characteristics of installment sales. Cf. Honnold, *supra* note 8, at 476-78. The section should, therefore, be amended. Two other Code sections, § 2-504 and § 2-614, curtail the perfect tender rule for minor alterations in the manner of tender. Those sections may also be subject to the objections noted above, but that is beyond the scope of this article.

IV. REVOCATION OF ACCEPTANCE

The goods in most market fluctuation cases are quickly resold or consumed, whereas, in most use cases, goods are retained for a substantial period of time. As a result, there is a greater likelihood of quality defects surfacing after acceptance in transactions involving use goods. Section 2-608 provides that a buyer may "revoke his acceptance" of a product "whose nonconformity substantially impairs its value to him" if he accepted the good in reasonable ignorance of the nonconformity or in the reasonable expectation that the seller would cure the defect. "A buyer who so revokes has the same rights . . . with regard to the goods . . . as if he had rejected them."⁶⁰

The substantial impairment limitation is meant "to preclude revocation for trivial defects or defects which may be easily corrected."⁶¹ The section thus attempts to eliminate bad faith revocations and the economic waste which allegedly results from reversing completed transactions for slight breaches. Neither of these goals justifies the substantial impairment limitation, for the same reasons as those enumerated above with respect to section 2-508.

Without the limitation, buyers would be able to revoke for any quality defects. The parties would then bargain respecting breach costs just as they bargained in the rejection context, the only difference being that the value of some cost categories will change, largely because bargains will concern used goods. These changes, however, do not affect the principle that the parties will optimize breach costs. The Code is again unnecessary to avoid economic waste. Moreover, the substantial impairment limitation requires buyers to continue with deals although they have not been compensated for certain breach costs; the unsatisfactory implications of this position have already been explored. Finally, the danger of bad faith revocations is slight. A rigorous demonstration of these points nevertheless requires a second set of models, because the Code affects bargains conducted in the revocation context in subtly different ways from those in the rejection context.⁶²

⁶⁰ Uniform Commercial Code § 2-608.

⁶¹ *Rozmus v. Thompson's Lincoln-Mercury Co.*, 209 Pa. Super. 120, 124, 224 A.2d 782, 784 (1966).

⁶² The purposes which the text attributes to the substantial impairment limitation are unnecessary to achieve § 2-608's original aims, which were: (1) to deprive sellers of price offsets to damage claims, since buyers who accept are liable for the price; and (2) to allow buyers both to rescind and to recover damages. The earliest draft of the section allowed revocation for any quality defect. See Report And Second Draft: The Revised Uniform Sales Act § 68-B & accompanying Comment (1941). The 1943 version provided that a buyer may revoke if "a hidden defect deprives him of the substantial benefit of the contract." 1943 Code, *supra* note 37, § 98d. By 1944 the phrase became "substantially impairs its value to him."

A. *Preventing Economic Waste*

Recall the gas range model, but assume the defects appear after acceptance. The cost categories are identical to those developed above, but the values may change. The costs to the seller of a lost sale or replacement will probably be higher because the transaction must be reopened, and returned used goods are worth less than returned new goods. The buyer's breach costs are substantially the same, except that non-use cost may be higher if the machine has replaced another, and the market discount and premium demanded because the item is "fixed" should be lower because the goods are now used. We assume: (1) that the buyer may rescind for any defect, as under the Uniform Sales Act;⁶³ (2) that price remains constant; and (3) that repair is successful.

1. $P = \$105$; $R = \$95$; $F = \$50$; $C_1 = 0$; $C_2 = \$10$; $C_3 = \$5$; $C_s = \$5$. Without the Code, the seller will repair and reduce the price by a maximum of \$15 ($F + \Sigma C = \$50 + 0 + \$10 + \$5 = \65). Breach costs are optimized, and are lower than in the rejection case.

2. The costs are the same, except that repair cost (F) is \$88. The seller will replace, for the total cost of repair is \$103 ($F + \Sigma C = \$88 + \$10 + \5) while $R = \$95$. Again, the least expensive alternative is selected, but breach costs are higher than in the rejection case partly because seller reversal costs are higher.

Let section 2-608 be applicable to examples three through six. There are four significant possibilities, only one of them good.

3. Assume that (1) without repair, the defects are sufficiently substantial to enable the buyer to revoke; (2) repair reduces C_1 to zero; (3) although the defects are substantial, the fact that C_1 can be reduced to zero precludes revocation if the seller repairs;⁶⁴ and (4) as with cure, if the seller repairs, he need not compensate the buyer for any breach costs which remain. In illustration one, where $F = \$50$, breach costs will be approximately the same under the Code as those incurred through bargaining, but the buyer unjustifiably bears \$15 of these costs because the seller will not reduce the price. In illustration two, the seller will also repair without reducing the price, yielding breach costs of \$103 ($F = \88; $C_2 = \$10$; $C_3 = \$5$), \$15 of which are, again, unjustifiably borne by the buyer. In this case, however, economic waste is produced since the least expensive alternative, replacement, costs \$95.

American Law Institute, Uniform Revised Sales Act § 98 (Proposed Final Draft No. 1, 1944). The draftsmen never explained this addition.

⁶³ L. Vold, *Handbook of the Law of Sales* § 95 (2d. ed. 1959); Williston, *supra* note 37, §§ 608a, 610, at 345-47, 350-54.

⁶⁴ Some courts apparently so hold. E.g., *Rozmus v. Thompson's Lincoln-Mercury Co.*, 209 Pa. Super. 120, 224 A.2d 782 (1966).

4. Let assumption 3 of illustration 3 be changed to permit revocation, despite the efficacy of repair. Here the buyer is in the illustration one situation, where the seller has no right to keep him in the deal. This is satisfactory.

5. Assume (1) C_1 , before repair, is only \$10 (the defects are slight), $C_2 = \$10$; $C_3 = \$5$; $C_s = \$5$; and (2) under the Code, only C_1 is relevant, and it is low enough to preclude revocation. If the Code were repealed, the buyer would rescind. Since $\Sigma C = \$25$ the seller would reduce the price by \$25 to \$30 to keep the deal. (Recall that $F = \$50$; $R = \$95$; $P = \$105$). Breach cost is this reduction. If the Code is applicable and the buyer cannot revoke, breach cost is \$25. The Code thus produces no economic waste, but it unjustifiably imposes this cost upon the buyer.

6. Assume (1) C_1 , before repair, is \$60 but all other costs are the same; and (2) again only C_1 is relevant, and it is held to be insubstantial. The buyer not only bears breach costs of \$75 (ΣC), but economic waste is produced since, if the buyer could revoke, the seller would repair and reduce the price, expending a maximum of \$65 ($F + \Sigma C$, when $C_1 = 0$ because of repair.)

The results in illustration three rest on the inability of buyers to revoke if repair is possible. They are the results which the Code invites because of its emphasis on cure and obvious distaste for revocation; yet these results seem erroneous, for the statute suggests that the right to cure does not survive acceptance.⁶⁵ Should the cases which facilitate the results in illustration three be overruled, the Code remains troublesome, since its emphasis on substantial impairment and on "conforming" tenders again invites courts to ignore nonuse, market discount and premium costs.⁶⁶ Finally, section 2-608 makes the result in illustration six possible because the phrase "substantial" is apparently irreducibly ambiguous. Is a \$60 cost on a \$350 purchase substantial? If not, what would be? How is

⁶⁵ Section 2-508(1) authorizes cure only during "the time for performance." That time will generally have expired when the buyer attempts to revoke. Sections 2-508(1) & (2) also suggest that cure may only be made after rejection. Thus § 2-508(2) begins: "Where the buyer rejects a non-conforming tender . . . the seller may . . ." However, § 2-608(3) provides that buyers who revoke have "the same . . . duties with regard to the goods involved as if . . . [they] had rejected them." This probably refers to § 2-603, which specifies the duties, such as following reasonable seller instructions, imposed on rejecting merchant buyers; but it is at least arguable that one of the § 2-608(3) duties is to accept cure, if it can be made in conformity with the requirements of § 2-508. See Phillips, *Revocation of Acceptance and the Consumer Buyer*, 75 *Com. L.J.* 354, 357 (1970); Note, 6 *Rutgers Cam. L.J.* 387, 414-15 (1974). If that construction obtains, illustration three above may become common, and illustration four rare.

⁶⁶ Some courts apparently have adopted the invitation. See *Akron Brick & Block Co. v. Moniz Eng'r Co.*, — *Mass.* —, 310 *N.E.2d* 128 (1974); *Rozmus v. Thompson's Lincoln-Mercury Co.*, 209 *Pa. Super.* 120, 224 *A.2d* 782 (1966); *Reece v. Yeager Ford Sales, Inc.*, 184 *S.E.2d* 722 (W. Va. 1971). Cf. *Collum v. Fred Tuch Buick*, 6 *Ill. App. 3d* 217, 11 *UCC Rep. Serv.* 333 (1972).

one to know? Unsurprisingly, the courts have developed no criteria to resolve these issues.⁶⁷ The Code, therefore, once more bears no relevance to the goal of reducing economic waste, and it causes harm.⁶⁸

B. *Bad Faith*

Bad faith revocations caused by the opportunity to make a better deal later will be rare, for the same reasons that rejections on this ground are rare.⁶⁹ A second motive for bad faith revocation may be that the buyer, after use, decides that the goods are not what he "really wanted," although the defects would not have caused revocation if performance were subjectively satisfactory. Conditioning revocation on the existence of substantial defects helps prevent this behavior. For several reasons, however, this problem is not serious. First, bad faith revocations for trivial defects may be deterred by section 2-607(4), which requires buyers to establish "any breach with respect to the goods accepted,"⁷⁰ and by section 2-608(2), which requires revocation to be "within a reasonable time after the buyer discovers or should have discovered the ground for it," and which precludes revocation when there has been "any substantial change in condition of the goods . . . not caused by their own defects."⁷¹

Second, in the revocation case the seller usually has possession of some or all of the purchase price. If he suspects bad faith, he is unlikely to return it voluntarily. Thus, a buyer who merely changes his mind about the deal may often have to sue to recover the price. This should deter light-hearted revocations. Third, when the defects themselves are not troublesome it is generally less costly for buyers to continue with a deal. If, for example, a business buyer has

⁶⁷ For an interesting example of judicial struggle with these questions, see *Campbell v. Pollack*, 101 R.I. 223, 221 A.2d 615 (1966).

⁶⁸ Illustrations 5 and 6 may seem unrealistic because the seller, by delivering defective goods and not curing, has breached, thereby enabling the buyer to recover the difference between the goods value as warranted and as accepted under § 2-714(2). This objection is unsound for two reasons. First, since the costs at issue are not "substantial," they often may not be great enough to make litigation worthwhile, which means that buyers will continue to bear them. Second, relying on litigation to enable buyers to shift costs back to sellers is inefficient, because litigation is generally more costly than bargains. However, when part of the purchase price is unpaid, buyers may withhold payments, pursuant to § 2-717, to force price reductions. This seems satisfactory, except that the practice may require more commercial sophistication than some consumer buyers have, and an ability to withstand seller threats which some may lack. Of greater significance, it is erroneous to defend § 2-608 by showing that another Code section can be used on occasion to ameliorate its defects, when those defects can be eliminated by deleting the offending statutory clause with no loss to the values the Code seeks to achieve.

⁶⁹ See text in Pt. III, at 556-65 *supra*.

⁷⁰ Uniform Commercial Code § 2-607.

⁷¹ *Id.* § 2-608(2).

installed a machine, he would rather use it than buy another, for repurchase increases search costs and the interim between revocation and repurchase may disrupt operations. Also, overcoming inertia—revoking, searching again, making and receiving threats, calling lawyers—entails substantial costs. The facts in many cases thus reveal serious efforts on the part of buyers to have sellers correct defects, with revocation a last resort.⁷² Thus, the danger of buyers revoking because they have changed their minds seems slight.

The final potentially significant form of buyer bad faith, the seeking of extortionate price decreases, seems somewhat less likely in this situation than in the rejection case. Such conduct is primarily engaged in, if at all, by businessmen, for consumers probably lack the sophistication. In addition to the deterrents noted above, business buyers for use also face reversal costs; for example, returning a machine which has already been integrated into plant operations may be expensive.

C. *The Choices*

The substantial impairment limitation is unnecessary to avoid economic waste and, in fact, it may produce waste. In addition, it often leads to the unjustifiable imposition of breach costs on buyers; and it is dysfunctionally ambiguous. The limitation will ameliorate the effects of buyer bad faith, but analysis indicates that bad faith should be even less common here than in the rejection case. Once again, the Code sweeps too broadly. Amending the Code to allow revocation for any defects unless sellers give appropriate price discounts is as unsatisfactory as the similar rule in the rejection context. Using a substantial impairment rule only when a buyer may be in bad faith seems similarly unacceptable. Consider, for example, the difficulty of determining whether revocation was motivated by the buyer's second thoughts or by the defects which actually exist. The best choice, therefore, is to eliminate the substantial impairment limitation.

V. CONTRACTING OUT

A. *Rejection*

If section 2-508 is repealed, many sellers will attempt to limit rejection rights contractually. As a result, the point at which bargaining occurs will shift, so that the parties will be bargaining about

⁷² E.g., *Orange Motors, Inc. v. Dade County Dairies, Inc.*, 258 So. 2d 319 (Fla. App. 1972); *Overland Bond & Inv. Corp. v. Howard*, 9 Ill. App. 3d 348, 11 UCC Rep. Serv. 945 (1972); *Zoss v. Royal Chevrolet, Inc.*, 11 UCC Rep. Serv. 527 (Ind. Super. Ct. 1972).

the *risks* arising from the possibility of breach rather than the *costs* a particular breach has already caused. Bargains cannot be rational unless information respecting their subject matter is available. Information as to breach costs, we have seen, is generally available. However, information respecting the risks of breach may not be. When information is unavailable, bargains as to these risks should be prohibited by the state; that is, sellers should be able to avoid the perfect tender rule only when buyers possess the information necessary to value the relevant risks or when sellers provide information to buyers who now lack it.⁷³ Because different limitations on the right to reject make different facts relevant, this point will be developed through an analysis of the common means of limiting rejection.

Sellers sometimes deal on the basis of certificates of compliance issued by neutral third parties who are named in the contract. These certificates are either final, or can be impeached only by other third parties whose authority the buyer is entitled to invoke. This practice should always be permitted. Only the third party's competence and integrity need be judged, and buyers can usually ascertain these.

Other limitations make different information relevant. Assume the contract accompanying the sale of a television set requires buyers to accept although the fine tuner is defective, but reduces the price by \$10 in this event. The breach cost categories are as described above. When the sale is made, a buyer faces a *risk* that the fine tuner will not work. The value of that risk (N) is the product of the probability of defects (p) and their cost; that is, $N = p\Sigma C$. The buyer must know whether \$10 accurately reflects the risk of a defective fine tuner: if $p\Sigma C$ is less than \$10 he should purchase; whereas, if $p\Sigma C$ is greater than \$10 he should demand a further price reduction. Most buyers can value the market discount and premium costs of a television set with a defective fine tuner. The costs of repair would also be ascertainable; a prospective buyer can phone a repair shop. Buyers with testing facilities, or those who purchase a substantial number of sets, will be able to determine the probability of a defective fine tuner. But other buyers, particularly

⁷³ When buyers cannot value the costs which particular contract clauses impose on them, they cannot make rational decisions as to whether a contract with or without such clauses more nearly corresponds with their wants respecting purchases, nor can they decide how much to offer sellers to delete certain terms or insert others. For further explanation of the undesirability of allowing bargaining in these circumstances, see Schwartz, *Optimality and the Cutoff of Defenses Against Financers of Consumer Sales*, 15 B.C. Ind. & Com. L. Rev. 499 (1974); Schwartz, *The Private Law Treatment of Defective Products in Sales Situations*, 49 Ind. L.J. 8, 17-28 (1974) [hereinafter cited as Schwartz]. Any imbalance of economic power between sellers and buyers, except as the result of differential access to information, should probably be irrelevant to the decision whether to permit or prohibit contracting out. See Schwartz, *Seller Unequal Bargaining Power and the Judicial Process*, 49 Ind. L.J. 367 (1974).

consumer buyers, will lack the technical facilities or expertise to make such a determination and, for reasons elsewhere developed, the market will be unlikely to inform them.⁷⁴ When that occurs, clauses requiring acceptance with an accompanying price reduction should be prohibited, unless the probability of defects is also disclosed; for without such disclosure bargains will be irrational because uninformed buyers will be unable to compare the price reduction with the risk they must bear. Finally, when sellers can ascertain repair cost more cheaply than buyers, this element of C_1 should also be disclosed.

Similar objections exist to contracting out by providing for substantial performance or requiring buyers to accept cure. The former offers buyers less information than a price discount clause, since at best it enumerates possible defects without the seller's estimate of their cost. A clause requiring buyers to accept cure probably ensures that the seller will assume the costs of repair (C_1). However, for the buyer to value the risk of incurring C_2 and C_3 , he must at least know the kinds of defects which are likely to arise and the probability of their occurrence. The ordinary repair and replacement clause does not communicate this; and where buyers are unlikely to ascertain this information on their own, contracting out is again of questionable merit.

Several considerations, however, argue against prohibiting contracting out unless information is disclosed. It will be difficult for legislatures or courts to decide which classes of buyers are sufficiently informed in a world where "sufficient" falls somewhere between ignorance and omniscience. Also, the compiling and transmitting of information is costly. Thus, in some cases the expense of requiring disclosure will make contracting out an impractical alternative. Sellers, however, generally know the probability of defects (p) and repair cost; thus, the major expense will be communication.⁷⁵ In theory, the final decision should depend on comparisons among: (1) the cost to sellers of providing information; (2) the cost to buyers and society of bargains made partially in ignorance; and (3) the cost to sellers of prohibiting contracting out. The costs which each of these alternatives entail will probably never be precisely

⁷⁴ Schwartz, *supra* note 73, at 13-15. See also R. Posner, *Economic Analysis Of Law*, 51-52 (1972).

⁷⁵ Manufacturers must approximate the probability of defects and some aspects of defect cost to operate quality control programs. See, e.g., R. Fetter, *The Quality Control System* 25-29 (1967); J. Juran & F. Gryna, *Quality Planning And Analysis From Product Development Through Usage* 56-60, 135-41, 148-49, 176-80, 361-67, 559-62 (1970). Deciding precisely what information sellers should disclose and policing seller disclosures will not be costless activities. At this stage, it is argued only that these costs do not seem so great as to preclude the attempt. Should events teach otherwise, different solutions can be pursued.

calculated but the choice can be approached with a broadly acceptable bias: society generally and sales law specifically are committed to bargains as the primary means of ordering transactions. This implies a commitment to creating the conditions under which bargaining may be rationally conducted. Society should, then, permit bargains only when the parties thereto can be adequately informed through their own efforts, unless the costs of this choice are excessive. Since sellers already know the central cost elements which must be disclosed—the probability of defects and the costs of repair and replacement—the costs of conditioning contracting out upon appropriate disclosure are unlikely to be great.

However, sellers avoid bad faith rejections by limiting the ability of buyers to reject. Conditioning the seller's right to so limit buyers on disclosure by the seller, in situations where buyers are likely to be uninformed, will increase the expense of exercising this right, and therefore raise a conflict between the policy of limiting bad faith rejections and the policy of limiting irrational bargaining. In practice, this conflict is less serious than it might appear. Bad faith appears to be primarily a business phenomenon; rejections, because of market decline or the later availability of a better deal, and extortionate rejections of products which are hard to resell, appear to be the behavior of professional buyers who possess the expertise and self interest to so act. Information gaps, however, occur primarily in markets where buyers are unsophisticated. Thus, requiring disclosure only when buyers lack knowledge should not significantly increase the risk of bad faith rejections.

In any event, the decision to repeal section 2-508 should not turn on the solution to the contracting out problem. In the markets in which buyers are informed, repeal of the section will improve matters. When buyers lack information, repeal plus freedom of contract will, at worst, work no change; for with the current statutory right to cure, all buyers, in deciding whether to purchase, must now value the costs of their sellers' right to cure. Furthermore, repeal with limitations on the right to contract out may make bargains more efficacious, probably without creating excessive costs.

B. *Revocation*

Sellers often attempt to limit their buyers' right to revoke acceptance by the use of such clauses as the standard repair and replacement term, which bind buyers to accept cure by repair. If the substantial impairment limitation is repealed, this practice should increase. The same arguments made above with respect to contracting out in a rejection context apply here as well. Moreover, the cases

indicate that courts presently limit contracting out in situations where buyers are unable to evaluate the costs of clauses eliminating the right to revoke.⁷⁶ The standard judicial technique is to read a term whose object is to have the buyer accept repair as a guarantee that repair will be successful, so that, when it is not, buyers can avoid the deal. In thus allowing revocation, one court explained:

After the purchase of an automobile, the same should be put in good running condition; that is the seller does not have an unlimited time for the performance of the obligation to replace and repair parts. The buyer of an automobile is not bound to permit the seller to tinker with the article indefinitely in the hope that it may ultimately be made to comply with the warranty. . . . At some point in time, if major problems continue to plague the automobile, it must become obvious to all people that a particular vehicle simply cannot be repaired or parts replaced so that the same is made free of defect. . . .⁷⁷

While such judicial treatment may, in particular cases, be preferable to allowing contractual avoidance of the perfect tender rule, it is plainly not ideal. The need for a further statutory response is evident.

VI. CONCLUSION

Section 2-508's cure rule and the substantial impairment limitation which section 2-608 imposes on the right to revoke acceptance rest on erroneous assumptions as to how bargains respecting breach work. One of these assumptions is that the parties cannot optimize breach costs without the aid of the law. That assumption is erroneous, for bargains optimize breach costs unaided. The final two assumptions as to how bargains respecting breach work are that waste producing, bad faith rejections, and revocations occur with sufficient frequency to cause concern and that sellers need the Code's protection to avoid them. These also are mistaken: bad faith occurs less frequently than is commonly supposed, because the costs to buyers of acting in bad faith often exceed the gains which could be derived from such action; and when that is not so, sellers generally protect themselves by contractually limiting the right of buyers to reject. Bargains, in sum, will themselves achieve the goals

⁷⁶ E.g., *Tiger Motor Co. v. McMurtry*, 284 Ala. 283, 224 So. 2d 638 (1969); *Jacobs v. Metro Chrysler-Plymouth, Inc.*, 125 Ga. App. 462, 188 S.E.2d 250 (1972); *Moore v. Howard Pontiac-American, Inc.*, 492 S.W.2d 227 (Tenn. App. 1972).

⁷⁷ *Orange Motors, Inc. v. Dade County Dairies, Inc.*, 258 So. 2d 319, 320-21. (Fla. App. 1972) (citations omitted).

toward which the cure and substantial impairment rules strive, thereby making those rules superfluous. Unfortunately, these rules are more than superfluous for they often operate to impose breach costs unjustifiably on buyers, and sometimes to produce the economic waste it is their purpose to avoid. Section 2-508 should thus be repealed and the substantial impairment limitation deleted from section 2-608. Matters will in some cases be made better, and cannot be made worse, if no more is done than excise these two sections from the Code.

Should these suggestions be adopted, many sellers will attempt to avoid the perfect tender rule by contract. Bargains will be concerned with what should be done in the event of breach, not what should be done about a breach which has already occurred; that is, the parties will bargain over risks, not incurred costs. Such bargaining poses quite different legal issues. Risk costs cannot be optimized unless the parties are sufficiently informed respecting them, but many buyers will lack necessary information. The problems encountered with respect to bargaining about the risks of breach are but one facet of a more general issue with which sales law has never adequately coped—when should risk shifting by contract be permitted or conditioned? It may be wiser to resolve the problem of contractually avoiding the perfect tender rule as part of an overall solution to the contractual risk shifting problem, since piecemeal solutions may create additional difficulties.⁷⁸ However, comprehensive reform can take a very long time. Therefore, the Code should be amended to permit sellers to avoid the perfect tender rule only when their buyers can themselves value the costs imposed by this form of risk shifting, or when sellers provide the requisite information to buyers who now lack it.

⁷⁸ One difficulty would be the problem of coordinating disclosure requirements. Consider, for example, a typical home solicitation sale of a stereo on credit in a state which has adopted the Code and the Uniform Consumer Credit Code (UCCC). The seller must already "conspicuously" disclose: (1) the warranty disclaimer, Uniform Commercial Code § 2-316(2); (2) the buyer's obligation to notify the (named) assignee of claims or defenses arising against the seller within three months of the sale, UCCC § 2.404(1); (3) the buyer's right to cancel within three days, FTC Rule, Cooling-Off Period for Door-to-Door Sales, 16 C.F.R. § 429.1, at 521 et seq. (Supp. 1974); (4) a description of the stereo, UCCC §§ 2.304(1), 2.306(2)(a); (5) the cash price plus sales tax, UCCC § 2.306(2)(b); (6) the downpayment, UCCC § 2.306(2)(c); (7) the difference between the cash price and downpayment, UCCC § 2.306(2)(c); (8) a description of the insurance on the stereo together with the buyer's right to purchase other insurance if he chooses, UCCC §§ 2.306(2)(h), 2.202(2)(a); (9) the amount financed, UCCC § 2.306(2)(i); (10) the credit service charge, UCCC § 2.306(2)(j); (11) the annual percentage rate, UCCC § 2.306(2)(k); (12) the number of payments, their amounts and due dates, UCCC § 2.306(2)(l); (13) the delinquency charge in the event of late payment, UCCC § 2.306(2)(m); (14) a description of the security interest, UCCC § 2.306(2)(n). If sales contracts are to contain many more "conspicuous" disclosures, buyers may only read fine print. Also, the total cost of making disclosure under several statutes could be great, so that deciding at one time which disclosures must be made and setting priorities among them would be essential.

